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FISCAL IMPACT STATEMENT

LS 7571 | **NOTE PREPARED:** Jan 6, 2003
BILL NUMBER: SB 1 | **BILL AMENDED:**

SUBJECT: Economic Development.

FIRST AUTHOR: Sen. Ford | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X **GENERAL** | **IMPACT:** State & Local
X **DEDICATED**
FEDERAL

Summary of Legislation: The bill authorizes the use of state tax revenue, exceeding a base allocation amount, to be used for payments of bonds issued, loans entered into, or leases entered into for an industrial development project in a distressed area. The bill provides that the same definition of distressed area be used for programs involving industrial development projects and the Growth Investment Program Fund.

The bill exempts purchases of equipment for research and development in biotechnology, advanced manufacturing, information technology, or 21st century logistics from Gross Retail and Use Taxes.

The bill also increases the Research Expense Credit to 20% of research expenses and makes the credit permanent.

It provides a state tax credit to a small business equal to: (1) 30% of the depreciable cost of certain property placed in service in a trade or business conducted by the small business when the small business places property in service in Indiana; or (2) 30% of the employee expenses incurred for new employees when the small business adds at least five jobs to the Indiana workforce.

The bill establishes a 15% Technology Commercialization Tax Credit against state tax liability for expenses incurred to commercialize technology developed in Indiana.

The bill also expands the authority of the Indiana Port Commission to finance and operate projects other than port projects on Lake Michigan, the Ohio River, or the Wabash River.

Effective Date: July 1, 2003.

Explanation of State Expenditures: *Port Commission:* The bill expands the Port Commission's authority beyond financing and building port projects. In addition to port projects, the bill authorizes the Port Commission to issue revenue bonds with a maximum maturity of 40 years to finance projects involving the following (Note: Under current statute, port revenue bonds have a maximum maturity of 50 years.):

(1) Any Commission facility related to nonmaritime port and traffic exchange points throughout Indiana for the transfer of goods and passengers between any modes of transportation.

(2) Any other Commission facility or project, whether located at a port or elsewhere in Indiana, that is either authorized by law or that the Commission finds will enhance, foster, aid, provide, or promote: (a) economic development; (b) private-public partnership; (c) industrial, commercial, business, transportation, recreational, cultural, or governmental purposes; or (d) other uses, activities, and purposes approved by the Commission.

Since the Commission is a body both corporate and politic, the revenue bonds do not constitute a debt of the state. In addition, the bill requires that revenue bonds of the Commission be secured with revenues derived by the Commission from the project financed with the bond proceeds or from other property of the Commission. The Port Commission would incur additional administrative expenses relating to the expansion of project financing authority. Additional staffing that may be necessitated by this expansion is unknown at this time. The Port Commission currently has 11 employees staffing its Indianapolis office, with 23 port employees located in Mt. Vernon, Jeffersonville, and Portage.

Indiana Department of Commerce (IDOC) & Indiana Development Finance Authority (IDFA): The Small Business Job Creation Credit and the Technology Commercialization Cost Tax Credit established by the bill would create additional administrative demands for the IDOC. The IDOC is responsible for certifying small businesses that are eligible for the Job Creation Tax Credit; and for determining eligibility of taxpayers for the Commercialization Cost Tax Credit. For Job Creation Tax Credit, the IDOC must certify (1) the project resulting in employment of the new employees; (2) the maximum amount and duration of the tax credit; and (3) the minimum number of new employees. For the Commercialization Cost Tax Credit the IDOC must make determinations relating to (1) the type of investment in commercialization costs and (2) that commercialization costs equal at least $250,000 in the first year and $2 M over the four years of the tax credit. In addition, the bill requires the Indiana Development Finance Authority (IDFA) to review and designate industrial development tax allocation areas in distressed counties. Currently, there are 35 counties that would qualify under the bill for tax allocation areas. Under current statute, the IDOC must provide administrative assistance to the IDFA. Currently, the IDFA has a staff of approximately eight. The additional administrative responsibilities given the IDOC and the IDFA under the bill presumably could be absorbed given their existing budgets and resources. The December 7, 2002, state staffing table indicates that the IDOC has 52 vacant full-time positions, including regional office positions.

Department of State Revenue (DOR): The DOR would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate the tax credits established under this bill. Also, as a result of these tax credits, the DOR would have to establish requirements for information submissions by taxpayers claiming these tax credits; and also monitor claims for various tax preferences that reduce the tax credits under the bill. The DOR must establish a method by which the Small Business Expansion Credit is apportioned to property when the maximum credit is claimed. Under claw back provisions of the bill, the DOR also would have to oversee both disallowing credit claims and seeking repayment of credit amounts by taxpayers who fail to remain eligible for the Commercialization Cost Tax Credit. The bill also gives the DOR responsibility for determining base (sales and income tax) allocation amounts for purposes of tax allocations in industrial development project areas. These expenses presumably could be absorbed given the DOR's existing budget and resources.

Other Administrative Impacts: The Auditor of State is required to administer the industrial development project area funds established in connection with tax allocation areas designated by the IDFA. These expenses presumably could be absorbed given the DOR's existing budget and resources. The bill also requires the Department of Workforce Development (DWD) to annually provide to the IDFA a list of the counties that meet distress criteria for purposes of designating tax allocation projects.

Explanation of State Revenues: *R & D Sales Tax Exemption:* This bill exempts certain purchases of equipment used for research and development in the areas of biotechnology, advanced manufacturing, information technology, or 21st century logistics from the state Sales Tax. Based on data adjusted from the National Science Foundation and U.S. Census Bureau, it is estimated that exempting these purchases from the Sales Tax could reduce state revenue by an estimated $35.0 M in FY 2004 and $39.4 M in FY 2005.

Sales Tax revenue is deposited in the Property Tax Replacement Fund (50%), the state General Fund (49.192%), the Public Mass Transportation Fund (0.635%), the Commuter Rail Service Fund (0.14%), and the Industrial Rail Service Loan Fund (0.033%).

Research Expense Credit: This bill increases the Research Expense Credit from 10% to 20% for tax years beginning January 1, 2004, and makes the credit permanent. It is currently set to expire December 31, 2004. It is estimated that these changes will result in an additional revenue loss of approximately $25 M in FY 2005.

Over the past four years, the current Research Expense Credit has ranged from $9.2 M in FY 1996 to $24.2 M in FY 1999. However P.L. 192-2002ss increased the credit to 10% and eliminated the apportionment formula. Consequently the cost of the base credit was estimated to increase by an additional $47.9 M in FY 2004 and $51.5 M in FY 2005 for a total cost of $72.1 M in FY 2004 and $75.7 M in FY 2005. This bill will potentially increase the total cost of this credit to approximately $100 M in FY 2005. Research Expense Tax Credits affect revenue collections deposited in the General Fund.

It is difficult to estimate the exact impact of continuing this tax credit since it is dependent on both the amount of research expenses individual taxpayers make during the year and their total tax liability. With additional incentives created for research and development activity based in the state of Indiana, the revenue loss from this credit could increase by an indeterminable amount. The credit provides $100,000 for each $1 M in new research expenses. Increased expenditures on research activities could also generate additional Adjusted Gross Income and Sales Tax revenue if these expenses are used to hire additional employees or purchase related equipment.

Sales/Income Tax Allocation Projects: The bill provides for the allocation of incremental state Sales, Use, and Adjusted Gross Income (AGI) tax revenue to pay for industrial development projects designated by the Indiana Development Finance Authority (IDFA). These tax allocation projects are limited to counties determined under the bill to be "distressed areas." Currently, there are 35 counties that meet the distress criteria specified in the bill. The amount of incremental tax revenue that could potentially be allocated to pay the costs of tax allocation projects statewide is indeterminable. The amount of incremental tax revenue diverted to tax allocation projects presumably <u>does not</u> represent a revenue loss to the state to the extent that the incremental revenue is attributable to the industrial development project or subsequent economic activity in project facilities. However, the state does incur a revenue loss to the extent that the diverted revenues are attributable to underlying growth in tax revenue. Sales and Use Tax collections increased from FY 1998 to FY 2002 by an annual average of 3.75%. During the same period, individual AGI Tax collections increased about 0.8% annually. (This includes the one-year decline in FY 2002 of about 6.3%.) From FY 1998 to FY 2001, however, individual AGI Tax collections increased by an average of 3.26% annually. These provisions of the bill are effective July 1, 2003. Thus, depending upon how quickly the IDFA begins the tax allocation project designation process, the bill could potentially impact state revenue beginning in FY 2004, but more likely in FY 2005.

The bill authorizes the IDFA to designate an industrial development project as a tax allocation project, provided it is located in a county that the Department of Workforce Development (DWD) has determined to be a distressed area. A county is distressed if: (1) the county annual unemployment rate exceeds the state annual unemployment rate in each of the preceding five calendar years; or (2) the county annual unemployment rate is at least double the state annual unemployment rate in the preceding calendar year. Based on annual unemployment indicators from 1997 to 2001, 35 counties would meet the distress standard. Sales, Use, and AGI taxes allocated to pay development project costs must be: (1) attributable to the construction and development of the project and taxable events occurring in the facilities developed through the project; and (2) exceed the *base allocation* amount for the project area. The base allocation amount, determined by the Department of State Revenue, is the amount of Sales, Use, and AGI taxes yielded from taxable events in the project area in the year prior to the development project. Under the bill, incremental Sales, Use, and AGI taxes from development project areas must be deposited in an Industrial Development Project Area Fund for that project. This money must be used only to pay bonds, loans, or leases issued to pay for industrial development projects in the allocation area. Money in such an Industrial Development Project Area Fund does not revert to the state General Fund at the end of the fiscal year. However, once all project costs and obligations are paid, money remaining in such a Fund reverts to the state General Fund.

Small Business Expansion Credit: The bill establishes an Adjusted Gross Income (AGI) Tax credit for the depreciable cost of certain property acquired on or after July 1, 2003, and placed in service on or after January 1, 2004, in Indiana by a small business. The amount of credits that could potentially be claimed by taxpayers is indeterminable; but could potentially be reduced to the extent that taxpayers are unable to claim other tax credits or deductions they are prohibited from claiming with the Small Business Expansion Credit. The net revenue impact depends on the extent that collections from taxable activities and new employees attributable to the investment in new property is less than or exceeds the amount of credits claimed by small businesses. However, if the investment would have occurred in the absence of the tax credit, the net impact would be the total credits claimed by small businesses.

The bill provides for a nonrefundable AGI Tax credit equal the lesser of (1) 30% of the depreciable cost of qualified property placed into service in Indiana in a taxable year or (2) $600,000 in total for all qualified property placed in service in Indiana in a taxable year. The tax credit may be applied to the taxpayer’s tax liability or distributed to shareholders, partners, or members if the taxpayer is a pass through entity, over five taxable years (20% per year) including the taxable year that the property is placed in service in Indiana . (A pass through entity is an S-Corporation, partnership, trust, limited liability company, or limited liability partnership.) The taxpayer may carry forward any unused credit amount from a taxable year for a maximum of 10 subsequent taxable years. The 20% amount the taxpayer may apply in a taxable year excludes any part of the credit carried forward from a prior taxable year. The taxpayer is not eligible to carry back any unused credit. For pass through entities, the credit may be claimed by shareholders, partners, or members in proportion to their distributive income from the pass through entity. The tax credit is reduced to the extent that the taxpayer uses: (1) another AGI Tax credit for the same property, an investment in the same property, compensation paid to an employee who uses the same property, or a project that involves the same property;

or (2) an Enterprise Zone deduction for compensation paid to an employee who uses the property.

Revenue from the AGI Tax on corporations is distributed to the state General Fund. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of this revenue is deposited in the Property Tax Replacement Fund. Since the credit is effective beginning in tax year 2004, the fiscal impact would begin in FY 2005.

Eligible Taxpayer: A taxpayer is eligible for the AGI Tax credit if the taxpayer: (1) places *qualified property* in service in Indiana in a trade or business; (2) uses the property in Indiana in a trade or business during the useful life (as determined for calculating depreciation for federal income tax purposes) of the property; and (3) qualifies as a small business in the taxable year in which the property is placed in service in Indiana. A taxpayer is a small business if it is a sole proprietorship operated by a person, corporation, or pass through entity that: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) qualifies as a small business concern under federal law and federal Small Business Administration requirements. Under a noncode provision of the bill, a taxpayer is not eligible for the tax credit if the property is acquired before July 1, 2003, or placed in service before January 1, 2004.

Qualified Property: Under the bill, qualified property is: (1) tangible or intangible property for which a deduction for depreciation is allowed for federal income tax purposes or (2) any license, right, or interest in a patent, copyright, formula, process, design, pattern, knowhow, format, or other similar item for which an amortization deduction is allowable for federal income tax purposes. The property qualifies for the tax credit regardless of whether the taxpayer claims the depreciation or amortization deduction, as applicable, for the property for federal income tax purposes. Qualified property must be primarily used in Indiana in a trade or business that does not include the trade or business of renting or leasing property to another person or entity. In addition property is not eligible for the tax credit if: (1) it is acquired from a person or entity having certain federally defined relationships to the taxpayer; (2) the federal depreciation basis for the property in the hands of the taxpayer is determined in relation to the depreciation basis of the property in the hands of the person or entity from which the property was acquired; or (3) the property is used to substantially replace other property used by the taxpayer or a person or entity having a federally defined relationship to the taxpayer. Under the bill, the following property also is not eligible for the tax credit: (1) property that has been used in any other trade or business in Indiana for at least one year before it is acquired by the taxpayer; (2) licensed motor vehicles, airplanes, or other off-premises transportation equipment; and (3) property that is used in or as part of a private or commercial golf course, country club, massage parlor, tennis club, skating facility, racquet sport facility, hot tub facility, suntan facility, racetrack, retail food and beverage service facility, automobile sales or service facility, other retail facility, residential property, or package liquor store.

Small Business Job Creation Credit: The bill establishes an Adjusted Gross Income (AGI) Tax credit for the out-of-pocket expenses incurred on or after January 1, 2004, by a small business for new (full-time) employees. The amount of credits that could potentially be claimed by taxpayers is indeterminable; but could potentially be reduced to the extent that taxpayers are unable to claim other AGI Tax credits or deductions they are prohibited from claiming with the Job Creation Credit. The net revenue impact depends on the extent that collections from new employees on taxable compensation is less than or exceeds the amount of credits claimed by small businesses. However, if the new employment would have occurred in the absence of the tax credit, the net impact would be the total credits claimed by small businesses.

The bill provides for a nonrefundable AGI Tax credit equal to 30% of employee expenses attributable to the lesser of: (1) the number of new employees employed by the taxpayer in each month of the taxable year; or

(2) the number of new employees specified by the Indiana Department of Commerce (IDOC) in a new employee certification for the taxpayer. The bill limits the aggregate amount of credits claimed by a taxpayer to the maximum total credit amount certified by the IDOC (see *Explanation of State Expenditures*). Employee expenses that may be claimed for purposes of the credit are: (1) wages and other compensation, including deferred compensation; (2) the employer's share of social security taxes; (3) state and federal unemployment taxes; and (4) premiums and other payments made for pension, health care, disability, or death benefits for the employee or other person insured through the employee.

The tax credit may be applied to the taxpayer's tax liability or distributed to shareholders, partners, or members if the taxpayer is a pass through entity, over five taxable years beginning in the taxable year after the year in which IDOC certification was obtained. (A pass through entity is an S-Corporation, partnership, trust, limited liability company, or limited liability partnership.) The taxpayer may carry forward any unused credit amount from a taxable year for a maximum of 10 subsequent taxable years. The amount the taxpayer may apply in a taxable year excludes any part of the credit carried forward from a prior taxable year. The taxpayer is not eligible to carry back any unused credit. For pass through entities, the credit may be claimed by shareholders, partners, or members in proportion to their distributive income from the pass through entity. The tax credit is reduced to the extent that: (1) the taxpayer uses another AGI Tax credit for the same project, property used in the same project, an investment in the same project, or compensation paid to an employee who is employed in the same project or who uses the property that is part of the same project; or (2) the taxpayer uses an Enterprise Zone deduction for compensation paid to an employee who uses the property. The tax credit is also reduced to the extent that the taxpayer employs in the project fewer than the number of new employees specified in the IDOC certification, except if this is the result of a labor dispute or casualty loss.

Revenue from the AGI Tax on corporations is distributed to the state General Fund. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of this revenue is deposited in the Property Tax Replacement Fund. Since the credit is effective beginning in tax year 2004, the fiscal impact would begin in FY 2005.

<u>Eligible Taxpayer:</u> A taxpayer is eligible for the AGI Tax credit if the taxpayer: (1) is an IDOC-certified small business employer of at least five new (full-time) employees; (2) employs at least five new employees in Indiana; and (3) qualifies as a small business in the taxable year in which the taxpayer incurs employee expenses for new employees. A taxpayer is a small business if it is a sole proprietorship operated by a person, corporation, or pass through entity that: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) qualifies as a small business concern under federal law and federal Small Business Administration requirements. Employee expenses are not eligible for the tax credit if the individual is employed in the following types of facilities: a private or commercial golf course, country club, massage parlor, tennis club, skating facility, racquet sport facility, hot tub facility, suntan facility, racetrack, retail food and beverage service facility, automobile sales or service facility, other retail facility, residential property, or package liquor store. Under a noncode section, a taxpayer is not eligible for the credit for expenses incurred before December 31, 2003.

Technology Commercialization Tax Credit Program: The bill establishes a credit against the Adjusted Gross Income (AGI) Tax, Financial Institutions Tax, or Insurance Premiums Tax liability for qualified technology commercialization costs incurred on or after January 1, 2004. The amount of credits that could potentially be claimed by taxpayers is indeterminable. The net revenue impact depends on the extent that collections from employment or other investment attributable to creditable commercialization activities is less than or exceeds the amount of credits claimed by taxpayers. However, if the commercialization activities would have occurred in the absence of the tax credit, the net impact would be the total credits claimed by taxpayers.

The bill provides for a nonrefundable tax credit for costs relating to investment in machinery and equipment and obtaining rights to use or the use of technology, including fees related to patents, copyrights, and licenses. A taxpayer may receive credits for commercialization costs incurred in four taxable years at one business location. (Taxpayers may qualify for an additional four years of tax credits for costs at the same business location.) The credit amount in any taxable year is equal to 15% of money invested in commercialization costs for one business location. However, the credit amount may not exceed 50% of the taxpayer's tax liability in a taxable year after application of all other tax credits.

The tax credit may be applied to the taxpayer's tax liability or distributed to shareholders, partners, or members if the taxpayer is a pass through entity, over five taxable years beginning in the taxable year after the year in which IDOC certification was obtained. (A pass through entity is an S-Corporation, partnership, trust, limited liability company, or limited liability partnership.) The taxpayer may carry forward any unused credit amount from a taxable year for a maximum of 21 subsequent taxable years. The amount the taxpayer may apply in a taxable year excludes any part of the credit carried forward from a prior taxable year. The taxpayer is not eligible to carry back any unused credit. For pass through entities, the credit may be claimed by shareholders, partners, or members in proportion to their distributive income from the pass through entity. The tax credit is not available in a taxable year in which machinery and equipment is not in regular service in Indiana or for an investment for which another research and development tax credit is applied.

Revenue from the AGI Tax on corporations, the Financial Institutions Tax, and the Insurance Premiums Tax is distributed to the state General Fund. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of this revenue is deposited in the Property Tax Replacement Fund. Since the credit is effective beginning in tax year 2004, the fiscal impact would begin in FY 2005.

Eligible Taxpayer: Taxpayer eligibility is determined by the Indiana Department of Commerce. Eligible taxpayers must incur commercialization costs for a trade or business the taxpayer conducts. The costs must include the purchase or lease of machinery and equipment placed in and maintained in service in Indiana. The machinery and equipment must be used in relation to technology production or to produce resources essential to technology production. The commercialization costs must be equal to at least $250,000 in the first year of the credit, and $2 M for the four-year duration of the credit. The bill contains claw back provisions for taxpayers that do not meet these monetary investment requirements. The bill also permits a taxpayer certified for credits to sell the credits to another taxpayer for use in that taxable year or future taxable years. The credits must be sold for at least 75% of their value, and the purchaser must apply them in the same manner and against the same taxes as the taxpayer certified for the credits.

Port Commission: Revenue bonds for Port Commission projects authorized by the bill, interest on the bonds, proceeds from the sale of the bonds, and receipt of the interest and proceeds is exempt from taxation in Indiana, except for the Financial Institutions Tax and the Inheritance Tax. Under current statute, port revenue bonds receive the same tax-exempt status. Thus, the bill could result in the exemption of additional investment income from taxation, to the extent that taxpayers substitute investment in Port Commission revenue bonds for investments in taxable instruments.

Explanation of Local Expenditures:

Explanation of Local Revenues: *Port Commission:* The projects undertaken by the Port Commission, and property acquired or used by the Commission, would be exempt from property tax under the bill. Given that the bill substantially expands the types of projects that the Port Commission may finance and build, this could potentially remove many properties from the tax rolls. However, the bill provides that the property tax exemption does not apply to property occupied and used by a person or entity leasing property for more than one year.

State Agencies Affected: Indiana Port Commission, Indiana Department of Commerce, Indiana Development Finance Authority, Department of State Revenue, Department of Workforce Development, Auditor of State.

Local Agencies Affected: Local government units.

Information Sources: Indiana Port Commission website, www.portsofindiana.com. *2001 Annual Report*, Indiana Development Finance Authority.

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